

## **Report Narrative**

# DISTRICT OF COLUMBIA RETIREMENT BOARD

## FISCAL YEAR 2002

October 1, 2001 – September 30, 2002

## ANNUAL REPORT

### I. INTRODUCTION

The District of Columbia Retirement Board (the "Board") was established as an independent agency of the District of Columbia government by the U.S. Congress on November 17, 1979, through enactment of the District of Columbia Retirement Reform Act, as amended (the "Reform Act").<sup>1</sup> This measure provided the Board with exclusive authority and discretion to manage and control the District of Columbia Police Officers and Fire Fighters' Retirement Fund, and the Teachers' Retirement Fund (collectively the "Funds"). The Reform Act also sets forth the Board's structure, specific authority and legal responsibilities. As explained in more detail below, the Board's former responsibility for managing the Judges' Retirement Fund has since been assumed by the Federal government pursuant to Title XI of the Balanced Budget Act of 1997.<sup>2</sup>

To facilitate effective monitoring of the retirement system, the Reform Act and the Police Officers, Fire Fighters, and Teachers Retirement Benefit Replacement Plan Act of 1998 ("Replacement Plan Act")<sup>3</sup> require the Board to publish an annual report for each fiscal year.<sup>4</sup> This report provides detailed disclosure of the financial and actuarial status of the retirement Funds. The report is transmitted to the Congress, the Mayor, and the Council of the District of Columbia by April 28 of each year. The report is also made available for examination by participants and beneficiaries of the Funds at the principal office of the Board located at 1400 L Street, NW, Suite 300, Washington, DC 20005, and may also be viewed on the Board's website at [www.dcrb.dc.gov](http://www.dcrb.dc.gov).

### Legislative History

Prior to enactment of the Reform Act in 1979, eligibility and benefit rules, and financing arrangements for the pension plans for the District's Police Officers, Fire Fighters,

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<sup>1</sup> Public Law 96-122, 93 Stat 866, codified at D.C. Official Code § 1-701 et seq (2001).

<sup>2</sup> Title XI of the Balanced Budget Act of 1997 (Public Law 105-33, 111 Stat. 251), entitled the "National Capital Revitalization and Self-Government Improvement Act of 1997," amended the Reform Act to require the Federal government to assume full responsibility for continuation of the retirement program for Judges in the District of Columbia and thus relieved the District of all liability associated with the Judges' Retirement Fund.

<sup>3</sup> The Replacement Plan Act is codified at D.C. Official Code § 1-901.01 et seq (2001), Sept. 18, 1998, D.C. Law 12-152, § 101, 45 DCR 4045.

<sup>4</sup> The Board's fiscal year commences on October 1 and ends on September 30.

Teachers and Judges were authorized by various acts of Congress and administered by the Federal government. Financing was “pay-as-you-go,” meaning benefits were paid from general revenues when workers retired instead of being pre-funded throughout the careers of participating workers. This pay-as-you-go method of financing is actuarially unsound, and results in what is called an “unfunded actuarial accrued liability” (“unfunded liability”).

## **Unfunded Liability**

An unfunded liability results when assets set aside under an employer’s pension plan are accumulating at an insufficient rate to provide a pool of funds out of which the promised pensions can be paid when they become due. Consequently, when the Reform Act was enacted and required the District government (“District”) to assume responsibility for these pension plans in 1979, the unfunded pension liabilities that had accumulated (approximately \$2.6 billion) were also transferred to the District, and continued to grow through 1997.

## **“National Capital Revitalization and Self-Government Improvement Act of 1997”**

In response to a financial crisis confronting the District of Columbia, the Clinton Administration proposed a plan in 1997, to provide Federal financial relief to the District in various forms. One critical area of relief came in the form of a proposal for the Federal government to assume financial responsibility for most of the unfunded liability that it created and transferred to the District almost twenty years earlier. The unfunded liability had grown from \$2.6 billion in 1979 to approximately \$4.9 billion in 1997. With an increasing annual payment of over \$300 million, the District’s contribution to the retirement Funds was one of the largest single ongoing financial obligations, resulting in a progressively significant strain on the District’s limited financial resources. At the conclusion of many months of hearings and debate in the Congress over the Administration’s revitalization plan, Congress enacted Title XI of the Balanced Budget Act of 1997 (Public Law 105-33, 111 Stat. 251), entitled the “National Capital Revitalization and Self-Government Improvement Act of 1997 (the “Revitalization Act”).

The Revitalization Act amended the Reform Act, significantly reducing the District’s liability and its administrative responsibility to certain eligible participants and beneficiaries of the Police Officers and Firefighters’ Retirement Fund, and the Teachers’ Retirement Fund (“covered District employees”). The Revitalization Act saved the District \$250 million or more per year in total retirement Fund contributions.

As a result of the Revitalization Act, the District’s required contribution for the two Funds (Police Officers and Fire Fighters, and Teachers) in fiscal year 1999 was reduced from an amount estimated in excess of \$300 million to \$57.3 million. As earlier mentioned, the Revitalization Act created a separate Judicial Retirement Fund for Judges of the District of Columbia courts, requiring the Federal government to take full responsibility (all assets and obligations) for continuation (including administration) of that retirement program.

The Revitalization Act also required the District government to enact a replacement retirement plan for covered District employees whose plans were in effect frozen as of June 30, 1997. In response, the Council of the District of Columbia adopted the Replacement Plan Act.

Finally, the Revitalization Act required the Board to transfer accumulated assets from the retirement Funds with a value of approximately \$3.4 billion to the U.S. Department of the Treasury ("Treasury"), acting on behalf of the Federal government. After many months of negotiations between the Board, the District, and Treasury, the asset transfer was accomplished on May 1, 1999.

## **Board Structure**

The Board is currently comprised of twelve Trustees.<sup>5</sup> The composition of the Board is an expression of Congressional intent to balance the various interests represented by the District's Executive and Legislative branches as well as the Funds' participant groups. Accordingly, three Trustees are appointed by the Mayor, three are appointed by the Council of the District of Columbia, and the remaining six are elected by the participant groups (one each from the active and retired Police Officers, Fire Fighters, and Teachers). Two Trustees appointed by the Mayor and one of the Council appointees are further required by the Reform Act to possess professional work experience in the banking, insurance, or investment industry.

In addition to the statutory framework provided by the Reform Act for the Board's fiscal and operational responsibilities, the District of Columbia Municipal Regulations ("DCMR") contain an extensive set of rules and regulations promulgated by the Board (Title 7, Chapter 15) that address various structural and operating characteristics of the Board ("Board Rules"). For example, the Board Rules describe the various executive officers of the Board and their responsibilities, staff positions and functions, standing committees and their respective jurisdiction, and rules for the Board's open meetings.

The Board's operating budget is appropriated out of the investment earnings of the retirement Funds managed by the Board.

## **Operations of the Board and Staff**

By adhering to its asset allocation plan; periodically rebalancing portfolios when necessary; controlling transaction costs; selecting investment managers with an audited long-term track record and a disciplined investment process; and aggressively negotiating and renegotiating investment management fees, the Board has long managed the Funds in a sound, prudent and well-documented manner.

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<sup>5</sup> The Revitalization Act removed the Judicial representative from the Board after the successful transfer of the entire D.C. Judges' Retirement program to the Federal government in 1997.

Since inception, the Board has operated pursuant to a committee system. This structure provides a two-tiered process for fiduciary review and analysis. The Board currently has six standing committees: (1) Benefits; (2) Emerging Enterprise; (3) Fiduciary; (4) Investment; (5) Legislative; and (6) Operations.

Board policies and directives are implemented by an in-house staff of thirteen (13) authorized staff positions. The Board's staff currently maintains responsibility for in-house accounting, procurement, human resources, budgeting, information technology, investment program development and oversight, and legal review and counsel. These capabilities are further enhanced by the retention of outside consultants all of whom are directed by, and work closely with, senior staff.

## **Board Responsibilities**

The Board's primary responsibilities include, without limitation, the following:

- Managing the Funds on an actuarially sound basis;
- Exercising discretionary authority as fiduciaries to the Funds, solely in the interest of the participants and beneficiaries. All duties are discharged with the care, skill, prudence and diligence as would a prudent expert acting in a like capacity;
- Monitoring pension payments from the District government<sup>6</sup> to the Funds, as determined in accordance with the Replacement Plan Act, and structuring the Fund assets in a manner designed to diversify the investments of the Funds so as to maximize returns while minimizing the risk of large losses;
- Maintaining, in an appropriate depository, a cash reserve in an amount determined by the Board to be sufficient to meet current outlays for annuitants and other authorized retirement and disability benefits paid from the Funds;
- Engaging the services of (a) competent investment counsel(s), qualified under the Investment Advisers Act of 1940; (b) an enrolled actuary to conduct actuarial valuations, and determining the District payment due for the forthcoming fiscal year; and (c) an independent certified public accountant to conduct an examination of the financial statements, books and records of the Funds, in accordance with generally accepted accounting principles, in order to prepare an annual audited financial report for each of the retirement Funds; and
- Providing information to the participants and beneficiaries of the Funds that informs them of their rights and obligations under their respective retirement plans in the form of a "summary plan description" with appropriate amendments and updates to reflect substantive changes.

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<sup>6</sup> Federal contributions to the Funds were discontinued after fiscal year 1997 pursuant to Title XI of the Balanced Budget Act of 1997 (the "Revitalization Act").

## **II. HIGHLIGHTS OF THE BOARD'S ACTIVITIES**

In conjunction with its primary responsibility to manage the assets of the Funds, the Board was engaged in many other activities in fiscal year 2002, which are briefly highlighted below:

- Undertook a nationwide search and selected a new Executive Director, Betty Ann Kane, replacing Jorge Morales who announced plans to retire in early 2003.
- Conducted the second formal actuarial experience study of the Funds since the Board's establishment. The study compared the economic and demographic assumptions used in actuarial valuations to what actually happened, and led to appropriate adjustments in future assumptions.
- Completed work with the U.S. Department of the Treasury to issue updated retirement plan description summaries of the retirement programs which were distributed to all active and retired District police officers, fire fighters, and teachers.
- Participated in ongoing U.S. Treasury Benefits Administration Workgroup meetings to develop better coordination of information among the agencies responsible for benefits administration and investments for the District's retirement plans for police officers, fire fighters, and teachers.
- Appeared before the Council of the District of Columbia, Committee on Government Operations to testify on the Board's fiscal year 2003 budget request and to discuss the Board's administrative operations, investment program, and investment performance.
- Undertook an asset liability study and asset allocation study to update investment policy.
- Conducted an election for an active police officer from the Metropolitan Police Department to serve a four-year term on the Board.
- Conducted Trustee educational training sessions designed to: (1) facilitate Trustee compliance with fiduciary responsibilities; and (2) develop Trustee understanding of modern investment practices
- Conducted monthly Board and Investment Committee meetings.

### **Administrative Operations**

With respect to internal operations, the Board conducted regularly scheduled, well attended meetings of the Board and its various committees and encouraged all Trustees to participate in investment management workshops and educational training programs

designed to facilitate compliance with the high standard of care associated with their fiduciary responsibilities.

### **III. LONG-TERM INVESTMENT PROGRAM**

#### **Capital Market Overview**

The downturn in equity markets that began in 2000 continued, as world stock markets declined even further during fiscal year 2002. The Russell 3000 Index, a broad-based U.S. equity index, declined 18.8% during the period, while the MSCI EAFE Index, representing non-U.S. equity markets, was lower by 15.5% during the 12-month period ended September 30, 2002. Private equity investments also struggled, as the Cambridge Private Equity Index fell 10.8%.

Numerous factors contributed to the equity markets' poor performance during fiscal year 2002. Corporate scandals made headlines throughout the year, including those involving large U.S. companies such as Enron and Worldcom, which led to declining investor confidence in corporate America and equity markets generally. Internationally, there was continued nervousness over terrorism threats following the September 11, 2001 tragedy, as well as the looming possibility of a war with Iraq. Concern over corporate earnings was also a major factor, as investors found it increasingly difficult to justify the lofty valuations at which many stocks continued to trade. The fallout from the overspending on capital equipment in the telecommunications and technology sectors in the late 1990s continued to serve as a drag on company earnings and on worldwide equity markets as a whole.

The current bear market is proving to be one of the worst in the history of U.S. equity markets. The S&P 500 Index declined 43.7% (cumulative) from April 2000 through September 2002. By contrast, the Index dropped 42.7% in the 1973-74 bear market. In addition, the Index's negative return in calendar year 2002 marked the first time since the early 1940s that the Index has had three straight losing years.

One of the few asset classes that realized a positive return during fiscal year 2002 was fixed income, as the Lehman Aggregate Bond Index returned 8.6%. Interest rates continued to decline during the year, with the U.S. Federal Reserve lowering the federal funds rate to 1.75% in an attempt to boost the economy. A weak U.S. job market added to the general economic uncertainty, as investors sought the relative safety of U.S. Treasuries and investment-grade corporate bonds.

#### **Investment Objective**

The Retirement Board seeks to achieve a nominal rate of return that exceeds the 7.25% actuarial return assumption, at a level of risk commensurate with the levels of returns and consistent with sound and responsible investment practices. As a long-term investor, the Retirement Board emphasizes long-term results over short-term gains.

## Investment Performance

### Total Fund Long-Term Performance at a Glance

<i><b>10 Years Ended</b></i>	<i><b>Average Annualized Return</b></i>	<i><b>Total Fund Benchmark Return</b></i>	<i><b>Actuarial Assumed Return</b></i>
9/2001	10.0%	9.6%	7.25%
12/2001	10.1%	9.6%	7.25%
3/2002	10.3%	10.0%	7.25%
6/2002	9.6%	9.2%	7.25%
9/2002	8.2%	8.0%	7.25%

The Total Fund Benchmark is a portfolio comprised of the asset classes that make up the strategic asset allocation adopted by the Retirement Board in December 1998, as set forth in the table below.

### Strategic Asset Allocation

<i><b>Asset Class</b></i>	<i><b>Target Allocation</b></i>
Domestic Equities	43.7%
International Equities	20.0%
Fixed Income	30.3%
Private Equity	5.0%
Short-Term	1.0%

The return of the Total Fund Benchmark is a weighted-average of the passive benchmark returns of each of the asset classes. The assumption is that this return will exceed the actuarial investment rate of return over the long-term, thus assuring achievement of the Retirement Board's investment objective. Performance is calculated using time-weighted rates of return in compliance with AIMR (Association for Investment Management and Research) standards. Total return includes interest and dividends as well as capital appreciation.

For fiscal year 2002, the investment program (or Total Fund) returned -7.9% versus the Total Fund Benchmark return of -9.0%, thus outperforming the Total Fund Benchmark by 110 basis points for the year. As in fiscal year 2001, the primary driver of Total Fund outperformance was asset allocation. An overweight to U.S. fixed income helped the portfolio withstand some of the turmoil in the U.S. and international equity markets. As of September 30, 2002, the Total Fund's actual allocation to fixed income was 41.6%,



compared to a target allocation of 30.3%. This overweighting in fixed income was a significant positive contributor to the Total Fund's relative outperformance. Additionally, active management within the U.S. equity segment contributed positively to relative returns, as the segment outperformed its benchmark, the Russell 3000 Index, by 190 basis points.

Regarding peer comparisons, the Total Fund's performance in fiscal year 2002 ranked in the 67<sup>th</sup> percentile among a Watson Wyatt universe of other pension funds with assets exceeding \$1 billion. It is worth noting that over 95% of the pension funds in this universe had negative returns for the 12-month period ended September 30, 2002.

For the three-year period ended September 30, 2002, the Total Fund outperformed the Total Fund Benchmark by 250 basis points, returning -2.5% (annualized) versus -5.0% for the Benchmark. For the ten-year period ended September 30, 2002, the Total Fund achieved an annualized return of 8.2%, outpacing both the Total Fund Benchmark (8.0%) and the actuarial assumed rate of return. Exhibit A depicts the dollar growth of the Total Fund relative to both the Total Fund Benchmark and the actuarial assumed rate of return, which was 7.00% from inception through September 1997 and is now 7.25%.

### **Domestic (U.S.) Equities**

As noted above, for fiscal year 2002, the Retirement Board's domestic equity composite surpassed the Russell 3000 Index by 190 basis points, returning -16.9% versus the Russell 3000 return of -18.8%. For the three-year period ended September 30, 2002, the domestic equity composite returned -9.1% (annualized), outpacing the Russell 3000 by 250 basis points (-11.6%).

As of September 30, 2002, the domestic equity investment structure was in line with its target allocation regarding active/passive mix (70/30) and capitalization, but style exposure was 5% overweighted in favor of value versus growth. Also, asset allocation moved further away from strategic targets, as domestic equities were underweight (38.2% versus a target of 43.7%) due to weak absolute results.

### **International (Non-U.S.) Equities**

For fiscal year 2002, the Retirement Board's international equity composite slightly trailed the performance of the MSCI EAFE Index, declining -15.9% compared with the -15.5% return for the MSCI EAFE Index. For the three-year period ended September 30, 2002, the international equity composite led the MSCI EAFE benchmark by 280 basis points, returning -11.8% (annualized) versus -14.6%.

Underperformance for the fiscal year was attributable primarily to country selection, as the composite was underweight to Japan, which performed well relative to the benchmark, and also to sector allocation, in particular an overweighting in telecommunications securities. Asset allocation moved further away from strategic targets, as international equities were underweight (14.9% versus a target of 20.0%) due to continued deterioration in foreign equity markets.

## **Fixed Income**

For the one-year period ended September 30, 2002, the fixed income composite underperformed the Lehman Aggregate Index, returning 7.4% versus the benchmark return of 8.6%. The underperformance was primarily due to the composite's underweight to U.S. Government issues, which was the strongest performing sector within fixed income.

For the trailing three-year period, the fixed income composite's annualized return approximated that of the Lehman Aggregate Index, as the composite returned 9.4% versus 9.5% for the index. As of September 30, 2002, fixed income assets comprised 41.6% of the Total Fund, which was higher than the strategic target allocation of 30.3%. This overweighting was due to the strong performance of the fixed income composite relative to that of the other asset classes.

## **Private Equity**

As of September 30, 2002, the private equity composite had generated an internal rate of return ("IRR") of 8.4% since inception. This compares with an IRR of 10.5% as of September 30, 2001. The decline in IRR can be attributed mainly to the unrealized depreciation in the portfolio companies held by two partnerships, Behrman Capital II, L.P. and Blackstone Capital Partners III, L.P., as a result of the downturn in the telecommunication sector.

Since inception, the Retirement Board has made investment commitments in private equity partnerships totaling more than \$213 million, as of September 30, 2002. During this period, partnerships in the portfolio have drawn down over \$176.6 million and returned \$157.2 million in distributions. At the end of fiscal year 2002, private equity was slightly behind target allocation, with 3.9% of Total Fund assets invested in private equity compared with the target allocation of 5.0%.

## **Investment Activity**

During fiscal year 2002, the Retirement Board regularly reviewed the investment performance of the Total Fund, the various asset class composites, and each investment manager. Additional initiatives undertaken by the Retirement Board included:

- periodic rebalancing and management of cash flows;
- the implementation of a U.S. equity small/mid-cap growth manager change;
- a search for and the selection of a general investment consultant;
- the commitment of capital to two private equity partnerships;
- the selection of securities litigation counsel;
- conducting Trustee training; and
- the analysis of investment-related pension fund costs.

The most important decision the Retirement Board is faced with is its strategic asset allocation; that is, which asset classes to invest in and how much to invest in each asset class. During fiscal year 2003, the Retirement Board, with the assistance of its new general investment consultant, will embark upon a new asset/liability study to determine the most appropriate asset mix for the Total Fund. The Retirement Board will carefully evaluate the risk/reward tradeoff of various asset mixes, the ability of the Retirement Board to meet long-term pension obligations under such scenario, and the impact of different economic conditions on both assets and liabilities. Final adoption of the new asset/liability plan is currently expected in the second fiscal quarter of 2003. It will take the Retirement Board several quarters to fully implement the new structure.

## **Asset Balances**

As of September 30, 2002, the market value of the Retirement Board's assets was \$1.824 billion, a decline of approximately 3% from the total asset value at the end of fiscal year 2001 (\$1.879 billion).

In Exhibit B, fiscal year 2002 performance results for the Retirement Board's asset class composites, as well as for individual equity and fixed income managers, are presented by the Retirement Board's independent investment consultant, Watson Wyatt. Total asset balances for the two Retirement Funds as of the end of fiscal year 2002 are included in Exhibit C.

## **Risk/Reward Profile**

The Risk/Reward profile of the Total Fund for the five-year period ended September 30, 2002, can be found in Exhibit D. Total Fund risk (or standard deviation) is minimized through the allocation of assets among noncorrelated asset classes and further by style diversification. Periodic rebalancing back to the edge of the target range and closely monitoring investment manager performance will mitigate active risk. Historical and forward-looking expected returns, standard deviations, and correlations for each major asset class are critical elements in the development of an asset allocation strategy. Variability of actual asset class returns will occur from year to year.

## **Portfolio Holdings and Performance Comparison**

Section 162(b)(2)(C) of the Reform Act requires the Retirement Board to submit a schedule of the assets held in each of the retirement Funds. Section 125 of the Reform Act permits the Retirement Board to commingle the assets of the two retirement Funds for investment purposes. A composite listing of all of the assets held by the Retirement Board as of September 30, 2002, is included under Exhibit E.

Exhibit F compares the Retirement Board's Total Fund performance to the return of the Total Fund Benchmark. For the one-year period ended September 30, 2002, the Total Fund added approximately 110 basis points in active return, returning -7.9% versus the benchmark return of -9.0%.

#### **IV. DETERMINATION OF ANNUAL DISTRICT PAYMENT TO THE RETIREMENT FUNDS**

The Police Officers, Fire Fighters and Teachers Retirement Benefit Replacement Plan Act ("Replacement Plan Act")<sup>7</sup> establishes the method for calculating the employer (District of Columbia) contribution to the retirement funds of D.C. Police Officers and Fire Fighters, and Teachers (collectively the "Funds"). The Board's enrolled actuary must determine the level percentage of covered payroll, expressed as a percentage ("normal contribution rate") for each participant group. Under the Replacement Plan Act, the District must contribute this amount annually which – when combined with (i) the actuarial value of assets,<sup>8</sup> (ii) expected investment earnings, and (iii) future employee contributions – will pay for the benefits by the time the workforce leaves employment.

After the actuary certifies the normal contribution rate to the Board, the Board must certify to the Mayor and the Council of the District of Columbia the normal contribution rate applicable for the following fiscal year for each separate retirement fund comprising the Funds. In preparing each annual budget for the District of Columbia, the Mayor must include an amount for each separate fund that equals the normal contribution rate multiplied by an estimate of the applicable payroll as the District payment for the next fiscal year.

#### **V. ACTUARIAL VALUATION**

The Replacement Plan Act requires the Board's actuary to undertake an actuarial valuation of the retirement Funds upon request by the Board or at least once every 2 years.<sup>9</sup> The results of the actuarial valuation are presented in the Report of the Enrolled Actuary together with the actuarial certification of the District contribution dated December 20, 2000 (Exhibit H). On the basis of the actuarial valuation conducted by the Board's actuary Milliman USA (formally Milliman and Robertson) as of October 1, 2000 for fiscal year 2002, the Board certified the normal contribution rate for fiscal year 2002 as follows: 0.3% of covered payroll for teachers, and 24.4% of covered payroll for police officers and fire fighters.

Because the District payment to the retirement Funds is an estimated amount based upon certain actuarial assumptions, the Replacement Plan Act establishes a corrective mechanism for adjustments in the District contribution to the Funds each year for shortfalls and overpayments from the second prior fiscal year.

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<sup>7</sup> D.C. Official Code § 1-901.01 et. seq. (2001)

<sup>8</sup> An actuarial value of assets is the value of cash, investments and other property that belongs to a pension plan, as used by the actuary for the purpose of an actuarial valuation.

<sup>9</sup> D.C. Official Code § 1-907.03(a)(2) (2001)

## VI. FISCAL YEAR 2002 DISTRICT PAYMENTS

D.C. Code Section 1-907.02 stipulates:

"(a) Each fiscal year, the District shall ensure that a sufficient amount is appropriated for each separate fund comprising the Funds, as the District of Columbia payment to the Appropriate separate fund comprising the Funds, which shall be equal to, or greater than, the amount calculated as provided for in § 1-907.03, as determined by the enrolled actuary . . . ."

D.C. Code Section 1-907.03(b)(1) requires the D.C. Retirement Board to certify to the Mayor and the Council, not less than thirty days before the Mayor submits the budget for the District of Columbia government to the D.C. Council, the normal contribution rate of the District's payment to the D.C. Teachers' Retirement Fund and to the D.C. Police Officers and Fire Fighters' Retirement Fund. The Board approved the enrolled actuary's certification on December 21, 2000.

The following were the amounts certified by the Board as the District's fiscal year 2002 payments to each of the Funds, in millions.

<i><b>Description</b></i>	<i><b>Teacher' Retirement Fund</b></i>	<i><b>Police Officers and Fire Fighters' Retirement Fund</b></i>
Normal Contribution Rate	0.3%	24.4%
Estimated Fiscal Year 2002 Covered Payroll	\$343,700,000	\$251,700,000
Fiscal Year 2002 District Payment Before Adjustment Previous Shortfall	\$1,000,000	\$61,400,000
Shortfall (Overpayment) From Prior Years	(\$5,500,000)	\$1,400,000
<i><b>Fiscal Year 2002 District Payment</b></i>	\$0.0	\$62,800,000

The Mayor and the Council included in the fiscal year 2002 budget and the Congress appropriated in Public Law 107-96 enacted on December 21, 2001, \$0.0 million for a contribution to the Teachers' Retirement Fund and \$74.6 million for a contribution to the Police Officers and Fire Fighters' Retirement Fund. On January 18, 2002 the District paid the \$74.6 million appropriated. The appropriated amount included:

<i>Item</i>	<i>Amount</i>
Amount certified by the Board	\$62,800,000
Benefit change to include as covered payroll certain service longevity payments for Police Officers	\$10,000,000
Benefit increase pursuant to the Police and Fire Fighters Survivor's Annuity Adjustment Amendment Act of 2000	\$1,700,000
Benefit change to increase the annuity for children of deceased police officers and fire fighters	\$100,000
<b>Total Appropriated Amount</b>	<b>\$74,600,000</b>

## VII. ADMINISTRATIVE EXPENSES OF THE BOARD

The District of Columbia Appropriations Act of 2001 (Public Law 107-96) authorized 14 full-time equivalent positions and \$13.388 million to pay for legal, management, investment, and other fees and administrative expenses of the D.C. Retirement Board. Since those amounts were to be paid from the investment earnings of the Teachers' and the Police Officers and Fire Fighters' Retirement Funds, the Board exercised strict expenditure controls and spent only \$7.168 million of the authorized amount. Of this amount, 71% was expended for asset managers and investment consultants. The expenses are itemized in Exhibit J.

## VIII. RETIREMENT BENEFIT PROGRAM ADMINISTRATION

Currently, much of the responsibility for administering the retirement benefit programs for the teachers, police officers, and firefighters remains with several agencies of the District of Columbia government. The Retirement Board has exclusive responsibility for the investment of the assets of the two retirement funds.

The eligibility of police officers and fire fighters to receive retirement benefits, for instance, is determined by an adjudicating board in the D.C. Office of Personnel. This Police and Firemen's Retirement and Relief Board is responsible for establishing eligibility for regular and disability pensions, including the determination of an applicant's degree of impairment and the percentage of disability. Similarly, the Board of Education makes eligibility determinations with respect to teachers' benefits.

Once eligibility has been established by the applicable adjudicating authority, the Office of Pay and Retirement Services of the Office of the Chief Financial Officer of the District calculates the retirement benefit amount, adds the annuitant to the retirement rolls, and thereafter makes monthly payments regularly until the beneficiary becomes ineligible or dies.

Monthly, the Deputy Chief Financial Officer for Financial Operations and Systems certifies the amount necessary to meet the retirement annuity payroll for the month. The Office of Finance and Treasury of the Office of the Chief Financial Officer of the District draws and mails the retirement benefit checks.

All pension and survivor benefits that are the responsibility solely of the Federal government are reimbursed by the Federal government on a monthly basis.

All pension and survivor benefits that are a split responsibility of the Federal and District governments are being reimbursed by the Federal government on a monthly basis. A Memorandum of Understanding between the Federal and District governments provides that the Board reimburses the District Benefit Payment portion on an annual basis. After the Federal government issues final rules to calculate the Federal Benefit Payment amount, the Board will reimburse on a monthly basis the District Benefit Payment share of those benefit payments.

The District government is responsible for the total cost of benefit increases enacted after June 30, 1997. All such pension and survivor benefits are reimbursed by the Board on a monthly basis.

Periodically, the Board reimburses or is reimbursed by the Office of the Chief Financial Officer for the amount of refunds of contributions, purchase of prior service credit, and other cash transactions. The Board has recorded an estimated amount of that reimbursement, which amount is included in the audited financial statements presented in Exhibit G.

## **IX. ADDITIONAL INFORMATION REQUIREMENTS**

### **Changes in Investment Managers and Advisors**

During fiscal year 2002, there was one change in the Retirement Board's roster of investment managers. In November 2001, the Retirement Board terminated its relationship with Warburg Pinus, a domestic equities small/mid-cap growth manager, and hired Credit Suisse Asset Management, also a U.S. equities small/mid-cap growth manager.

In addition, the Retirement Board made capital commitments to two private equity partnerships, as well as retaining securities litigation counsel and a new general investment consultant.

### **Lease For Office Space**

Location of Leased Premises:  
1400 L Street, NW  
Suite 300  
Washington, DC 20005

Description of Leased Premises:

Office space consists of 6,374 square feet

Name of Lessor:

M-C Capitol Associates L.L.C.

Effective Date of Lease:

September 1, 2000

Term of Lease:

61 months

Minimum Rent:

The annual rental per square foot for fiscal year 2002 was \$32.13

**Other Disclosures**

The retirement programs coverage is disclosed in Exhibit K, the List of Fiduciaries and Service Providers and Schedule of Transaction with Persons Known To Be Parties-in-Interest is presented in Exhibit L, the Schedule of Trustees Activities Sponsored by Service Providers is presented in Exhibit M, the Summary of Lease Default is presented in Exhibit N, and the Custodian Bank's Balance Sheet is presented in Exhibit O.